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RESALE PRICE MAINTENANCE

by

William J. Waldron B.Comm.

A Thesis

**Submitted to the Department of Economics and Political Science
in Partial Fulfillment of the Requirements
for the Degree of Master of Arts at
the University of Windsor**

Windsor, Ontario

1965

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ABSTRACT

RESALE PRICE MAINTENANCE

The implications of resale price maintenance for the public interest continue to be interpreted differently by economists and businessmen. As a result of the investigation of the MacQuarrie Committee in 1951, resale price maintenance was banned unconditionally in Canada in the same year but recently a retrenchment of the position occurred with the amending of the Combines Investigation Act in 1960.

An examination of the history of the practice within modern retailing in the United Kingdom, the United States and Canada reveals a difference in the legal approach by the governments concerned. The more common arguments advanced in support of resale price maintenance fail in their objective when examined in relation to the benefits accruing to the consumer. The most prevalent aspect of these arguments, "loss-leader" competition, appears as an indeterminate concept because of the inability of both economists and businessmen to arrive at an acceptable definition. Nevertheless these same arguments give some insight into the motives of retailers, wholesalers and manufacturers for desiring the use of resale price maintenance. These motives evolve from the desire to either increase or protect present profits. Retailers who support the practice

admittedly desire protection from price competition but their reasons for entitlement to such protection fail to indicate any benefits for the consumer. Manufacturers claim many damaging aspects resulting from the use of their product as a "loss-leader", none of which are clearly substantiated. It appears that it is their profit margin which is damaged.

Resale price maintenance appears as detrimental to the public interest. It creates a favourable climate for price agreements at the various distributive levels. The consumer is forced to pay a higher price than might otherwise have been required if price competition were present. In addition he is made to pay for services which he may not desire and at the same time is denied his right to influence the distribution system thus retarding change in the structure of distribution. As a result inefficient uses of resources occur both in distribution and in manufacturing.

PREFACE

Combine laws designed to protect the public from monopolistic and restrictive practices exist in the greater majority of the countries of the western world. Because of the dynamic quality of modern economic development the need exists to frequently reexamine the relevance of such legislation to the rapidly changing economic conditions.

Resale price maintenance is one topic relating to combine law which has received increasing attention during recent times in both North America and Western Europe. There is no completely settled position on the practice although a tendency in one direction is appearing.

The purpose of this thesis is to evaluate the issues involved and to present a conclusion as to the position of the practice.

In acknowledging my indebtedness to the members of my thesis committee I wish particularly to thank the Chairman, Professor W. J. Gillen for his patience and encouragement. I am also grateful to Dr. W. G. Phillips and Dr. C. M. Birch for their direction and timely suggestions.

To the staff of the University Library I owe a large debt of gratitude for the cheerful way in which they filled my every request for assistance.

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CHAPTER I

INTRODUCTION

Resale price maintenance is the term used to identify a situation where a particular article is being resold by retailers, wholesalers or other distributors at either a fixed price or at not less than a specified price.

The particular price may result from either of two methods of agreement, horizontal or individual. Horizontal resale price maintenance exists where rival wholesalers or manufacturers collectively agree on the resale price. This type of price fixing agreement is generally recognized as being against the public interest and will not be discussed in this paper.

Individual resale price maintenance results when an individual supplier specifies a minimum or fixed price at which a particular article is to be resold. The manufacturer may state the price at which all wholesalers will resell his product or a wholesaler may specify the price at which retailers will resell a certain article. In other instances an individual manufacturer may specify the prices at both the wholesale and retail level. The arguments submitted herein will apply to any of these arrangements.

Individual resale price maintenance is associated primarily with branded or trade marked products. "The purpose of branding is to emphasize a distinction between a particular article or class of articles and all other articles not marked in the same way; it becomes effective when the public is aware of this distinction".¹ The manufacturer of a branded or trade marked product is in a position to undertake national advertising stressing real or alleged differences between his product and other comparable products with the objective of creating a demand for it.

Enforcement of individual resale price policies will be determined by existing legislation. Where the legislation permits, suppliers may require distributors to sign contracts agreeing to resell the product concerned at the indicated price. In some cases mere notification of the resale price may be sufficient or the signing of a contract by one distributor may automatically bind all other distributors. Under such arrangements the supplier is then in a position to take legal action against any distributors who do not resell at the stated price.

Where legislation does not allow the supplier recourse to legal action the opportunity may exist to attempt

1 Report of the Committee on Resale Price Maintenance

Lloyd Jacob Committee (London, 1949) p. 3.

enforcement of resale price maintenance by withholding supplies from distributors who resell below the stated resale price.²

With a policy of resale price maintenance the resale price may be established as a minimum price below which the article is not to be sold or it may be established as a fixed price at which the article is to be sold. The result will tend to be the same in either case. With a minimum resale price the distributor will be inclined to sell at this price as a result of competitive factors. The more general tendency appears to be to specify fixed prices.

In the examination of the practice of resale price maintenance the various stages of economic activity which connect the producer with the consumer become involved. Whereas traditional economic theory is concerned mainly with a single product situation involving manufacturing or agriculture,

2 "In 1926 the Owl drug chain operating on the Pacific Coast defied the established policy of E. R. Squibb & Company by announcing that it would sell Squibb's products at cut prices. This announcement precipitated a fight in which the Squibb Company was alleged to have arranged with druggists operating in the affected area to have them sell at cut prices, but at margins equivalent to those formerly enjoyed. This action, coupled with Squibb's refusal to sell to the Owl chain, brought the latter to terms in early 1927". An excellent example of the possible action that may be open to manufacturers. E. R. A. Seligman and R. A. Love. Price Cutting and Price Maintenance (New York, 1932) p. 39.

retailing, on the other hand, presents a different combination of factors which usually result in a multiple product firm. In addition the merging of the various stages of the distributive system is not generally covered in traditional theory.

The lack of any theoretical framework which can be directly applied to resale price maintenance presents two alternatives in the method of approach to the topic. One possibility involves the searching out of theoretical articles which are applicable and from these attempt to establish a model which fits resale price maintenance. The second choice consists of a more inductive approach in which arguments are examined and motives questioned in an effort to determine the economic consequences of the practice and to derive an assessment of its implications for the public interest.

The latter method has been chosen along with the resulting limitations to the scope of this discussion. As a consequence this thesis cannot answer all questions relating to combines' law.

It is accepted that in general economists have a bias toward price competition but at the same time reserve the

right to make exceptions where the situation warrants it.³

As this is in keeping with traditional theory it is therefore accepted as given the principle that restrictions on competition, price as well as other types, are presumed against the public interest unless proved otherwise. Consequently the reader will undoubtedly detect a bias toward price competition in the arguments which follow.

Resale price maintenance is said to have been in existence as far back as 200 B.C. but this discussion is concerned with its more recent history dating from the latter part of the nineteenth century and more particularly the developments since the end of World War II.

In Chapter II the development of the practice within the structure of modern retailing is examined with reference to the United Kingdom, the United States and Canada. The varied reception of the practice by the governments of the three countries is then outlined from the early twentieth century up to the present date.

In attempting to establish the thesis that resale price maintenance is detrimental to the public interest it becomes necessary to first examine the more common arguments presented

³ The existence of the argument against too perfect competition and its inhibiting effects on economic change as expressed by J. A. Schumpeter and others is acknowledged.

in support of the practice. Chapter III is devoted to such an examination with a rebuttal extended to each argument considered.

In the next chapter particular attention is focused on the "loss-leader" argument which is an inherent part of the major arguments rendered in support of resale price maintenance. The attempt is made to examine and analyse all aspects of "loss-leader" competition in arriving at a conclusion as to the strength and validity of the argument.

Chapter V consists of an endeavour to gain an insight into the underlying motives which may lead distributors to support resale price maintenance followed by a discussion of the possible economic effects that the practice may tend to have on the distribution system of the economy.

The more recent development of strong support and in some cases aggressive leadership originating with manufacturers requires a subsequent questioning of the possible motives behind these actions and it is to this which Chapter VI is assigned along with the resulting economic implications.

In conclusion the relevant points are examined in reference to their effect upon the consumer and upon economic efficiency. An effort is made to summarize the specific points which support and illustrate the detrimental nature of resale price maintenance.

CHAPTER II

ORIGINS AND RECENT HISTORY UNITED KINGDOM, UNITED STATES AND CANADA

The movement to foster the more widespread use of resale price maintenance appears to have gained significant impetus during the last two decades of the nineteenth century. The growing price competition in many branches of retailing provided the motivating force for the movement.

New types of retailing establishments were rapidly cutting into the trade of the small retailer. Department and chain stores, through their trading advantage, were able to offer the public numerous and significant price reductions, an attraction to which large sections of the public responded.

The competition provided by new methods of retailing was superimposed upon the probably more leisurely competition that existed among the typical small-scale retailer of an earlier period. The so-called 'legitimate' retailers (operating on a small or medium scale along traditional lines) felt the severe effects of the enhanced competition. The smaller share of the trade that remained for them had to be transacted at lower prices and margins of profit.¹

The branding or trade-marking of merchandise became much more prevalent during this period contributing to the severity of retail competition. By advertising, manufacturers of

¹ B. S. Yamey "The Origins of Resale Price Maintenance: A Study of Three Branches of Retail Trade", Economic Journal LXII, p. 524.

branded goods gained acceptance of their products by consumers and this preselling contributed to minimizing the need for specialized knowledge in retail selling. With the branded or trade marked products relatively easy to handle the large-scale retailers could now use unskilled labour for the now simplified function of selling. The entry of new firms into retailing was also made easier because of the reduced requirement for specialized knowledge. Branding also led to competition across product lines. Grocers could now sell tobacco products or patent medicines, since no specialized knowledge of the merchandise was necessary to sell the branded goods of other trades. Consequently the different retail trades began to compete with each other.

The small and medium sized retailers operating along traditional lines of specialization were hardest hit by this competition and were forced to seek out methods to improve their competitive position. Some groups of small retailers combined their purchases to secure the better terms which their bulk-buying rivals enjoyed. Others joined together to form trade organizations with one of the major objectives² being to negotiate with manufacturers in an effort to persuade them to adopt resale price maintenance.

² Ibid., p. 523.

Professor Yamey³ reveals that the great majority of manufacturers in the United Kingdom during the last decade of the nineteenth century were reluctant to adopt resale price maintenance. They did not appear to believe that uniform retail prices for a brand would be of any advantage to them. Price maintenance, at best, was regarded as an unfortunate restriction sometimes necessary in order to placate influential sections of the retail trade.

Demands for maintained prices forced a difficult decision upon the manufacturer. Since not all retailers were in favour of price maintenance the manufacturer was faced with an assessment of the relative strength of the two broad groups of supporters and opponents. In addition he had to judge the extent of the damage which each group was likely to inflict upon him if dissatisfied with his decision.

If frustrated by its introduction, the opponents of resale price maintenance would have a strong incentive to increase the sales of substitute brands. The larger firms could be moved to undertake production of competitive private brands and would be able to advertise extensively. Conversely supporters of price maintenance could indicate their dissatisfaction with non-protected goods by endeavouring to substitute other brands and by being uncooperative with manufacturers in

3 Ibid., p. 540.

their sales and promotion efforts and by keeping their lines poorly displayed or hidden from view. Associations of supporting retailers could sponsor the production of brands to be distributed solely by members. The London and District Tobaccoists Association introduced a selection of its own branded pocket tobaccos in 1892, and the Birmingham Association marketed its own brands in 1895.⁴

The retail trade associations used various arguments in their attempts to persuade manufacturers to adopt resale price maintenance. They consisted of a mixture of offers of friendship and support at one extreme through to threats of absolute boycott at the other. The amount of progress in overcoming the objections of the manufacturers depended to a great extent upon the strength of the retail organization. The strongest and most effective resistance came from producers of well established brands. The strongest and most persistent pressure from the retail trade originated with druggists.

The efforts to establish resale price maintenance in modern retailing originated in the period covering the last two decades of the nineteenth century and the first decade of the twentieth century. The movement was a result of the efforts of the independent small retailer to protect his profits from

⁴ Ibid., p. 533.

the danger which aggressive firms and their successful price policies presented. The movement originated with the retail trade and the majority of manufacturers who adopted the practice did so reluctantly in the beginning.

From this period resale price maintenance met with different attitudes on the part of the governments in the United Kingdom, the United States and Canada as revealed in part by the existence of or the lack of relevant legislation.

United Kingdom

It is only during the last two decades that the United Kingdom has enacted legislation aimed at the control of combines and restrictive practices. Prior to the Monopolies and Restrictive Practices Act of 1948 the United Kingdom had conducted public enquiries into the problems of resale price maintenance on several occasions.

A sub committee of the Standing-Committee on Trusts conducted the first enquiry in 1920. The majority of the committee found that resale price maintenance generally was to the advantage of the public, provided the maintained prices were fair and reasonable. To ensure this overriding provision, the committee recommended that resale price maintenance, together with other forms of restrictive business practices, should be subject to supervision by a tribunal which could investigate specific complaints of excessive charges and

would be empowered to take or recommend such action as necessary to correct the situation.

In 1930, another public inquiry, which also covered other restrictive business practices than resale price maintenance, was carried out by the Committee on Restraint of Trade. Although the committee viewed price maintenance as not free from disadvantage to the public, it was not satisfied that the public interest would be better served through a change in the existing law.

The Lloyd Jacob Committee was appointed in 1947 to investigate the practice of resale price maintenance. In its report rendered in 1949, the committee recommended no prohibition of individual resale price maintenance. But it also concluded that:

It appears to us to be contrary to the public interest for a manufacturer to use his power to cut off supplies in such a way as to obstruct the growth of particular methods of trading, to impede the distribution by another manufacturer of competitive goods or to deprive the public of the benefits of low cost systems of distribution.⁵

The recommendation for not banning the practice was based on the premise that it protected manufacturers of branded goods from the harmful effects of so-called "loss-leader" competition among resellers. The committee further recommended

⁵ Report of the Committee on Resale Price Maintenance.
(Lloyd Jacob Committee) (London, 1949) p. 23.

that the appropriate Government Departments discuss with the principal national organizations in trade and industry the most satisfactory means of removing the undesirable results of individual resale price maintenance. In addition it was recommended that collective resale price maintenance be made illegal.

As a result of the failure to resolve the undesirable effects of the practice, the Government issued a White paper in June 1951 announcing its intention of introducing legislation to make individual as well as collective resale price maintenance illegal. The legislation had not been introduced when a new government took office in November, 1951.

In December 1952, this government asked the Monopolies and Restrictive Practices Commission to conduct an inquiry into certain widely prevalent restrictive practices. The committee report was presented in 1955 and as a result the Restrictive Trade Practices Act of 1956 was passed.

The collective enforcement of resale prices was made illegal but manufacturers were now able to enforce individual resale contracts not only in the case of dealers who had signed a contract but also in the case of a person who acquires the goods with a notice of the resale price conditions.

Between 1960 and 1964 The Monopolies Commission concluded in two out of three reports on resale price maintenance

in particular industries that the practice was against the public interest and should be terminated.

In July of 1964, the Government passed the Resale Prices Act making resale price maintenance illegal effective April 30, 1965. Suppliers of goods were allowed to apply for exemption from the statutory prohibition of resale price maintenance from August 15, 1964 to November 15, 1964. Until a decision is rendered by the Restrictive Trade Practices Court the suppliers in question can continue with resale price maintenance. Suppliers applying after November 15, 1964 will have to await a favourable decision before commencing price maintenance.

The Act specifies that the Court may exempt a class of goods if it appears to the Court that in default of a system of maintained minimum resale prices applicable to those goods

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- (a) the quality of the goods available for sale, or the varieties of the goods so available would be substantially reduced to the detriment of the public as consumers or users of those goods; or
- (b) the number of establishments in which the goods are sold by retail would be substantially reduced to the detriment of the public as such consumers or users; or
- (c) the prices at which the goods are sold by retail would in general and in the long run be increased to the detriment of the public as such consumers or users; or

- (d) the goods would be sold by retail under conditions likely to cause danger to health in consequence of their misuse by the public as such consumers or users; or
- (e) any necessary services actually provided in connection with or after the sale of the goods by retail would cease to be so provided or would be substantially reduced to the detriment of the public as such consumers or users,

and in any such case that the resulting detriment to the public as consumers or users of the goods in question would outweigh any detriment to them as such consumers or users (whether by the restriction of competition or otherwise) resulting from the maintenance of minimum resale prices in respect of the goods.⁶

A substantial number of requests were submitted for exemption from prohibition of resale price maintenance by the time of the deadline on November 15, 1964. More recently⁷ there are indications that a growing proportion of the applications are being withdrawn because of competitive conditions or lack of legal basis for the request.

⁶ The Resale Prices Act, 1964, Sec. 5(2) as quoted by B. S. Yamey Resale Price Maintenance and Shopper's Choice, (London, 1964) p. 53.

⁷ See Economist, July 3, 1965, p. 58.

United States

The period prior to the 1930's was characterized by the uncertainty of the legal position of resale price maintenance. Under the Sherman Act of 1890, the Courts had held individual as well as collective price maintenance enforced by agreement or contract as illegal in interstate commerce.⁸ But the courts upheld the right of manufacturers to refuse to sell to dealers who had cut prices substantially.⁹

Manufacturers interested in establishing resale price control could attain it either by refusing to sell to dealers who cut prices or by shipping goods to dealers on consignment, retaining title until the goods were sold. The only other alternative was direct price control through sales agencies owned by the manufacturer.

Manufacturers found that refusal to sell enabled them to exercise a considerable degree of control over the resale price of their distributors (wholesalers). But in the case of the retail trade the number of retailers made it difficult for most manufacturers to deal directly with them.

Experience with resale price control had shown that

⁸ See E. R. A. Seligman and R. A. Love, Price Cutting and Price Maintenance, (New York, 1932) p. 54 for a discussion of the Hartman and Miles cases.

⁹ Ibid., pp. 65-8. Cream of Wheat, Goodyear and Colgate cases.

identical retail prices could be secured by means of resale price contracts. As a consequence, manufacturers of branded merchandise and trade association leaders in the retail field - particularly the drug trade - turned their efforts toward securing a legalization of resale price maintenance. The economic position of wholesalers being closely related to the profit return of retailers, they also joined in advocating resale price legislation.

The growth of chain and cut-rate stores offering limited services and lower prices coupled with the depression in 1930 gave greater impetus to the efforts of independent retailers and wholesalers to obtain the legalizing of resale price maintenance.

The retail and wholesale trade associations in California were the most aggressive in their demands. As a result, in 1931 California became the first state to legalize the use of resale price contracts in intrastate commerce. To be eligible the commodity concerned was required to bear the trade-mark, brand or name of the producer or owner and to be in fair and open competition with commodities of the same general class produced by others. The agreed upon prices were to prevail at all times except for closing out sales, the sale of damaged and deteriorated goods, and the sale of goods by order of a court.

An amendment to the California statute in 1933 added the highly significant provision that a single agreement to fix the resale price of a trade marked product is applicable to all other sellers even though they do not sign a price maintenance contract. This amendment which came to be known as the "non-signers' clause" made it possible for a manufacturer to make a resale price agreement with a single wholesaler or retailer and thereupon require all other wholesalers or retailers in the state to charge the same resale price for the product. Any distributor having notice of the contractual arrangement and not conforming to the prices became at once subject to civil action on the charge of unfair competition. This clause made the resale price control laws extremely effective in maintaining prices within the state.

In view of this, the California statute and amendment were rapidly adopted by a considerable number of other states at the request of organized trade groups.

As the laws applied only to intrastate commerce price maintenance still remained illegal in interstate commerce under the Sherman Act.

In response to the increasing demands of state and local trade associations, Congress in 1937 enacted the Miller-Tydings Act, amending the Sherman Act to exempt resale price agreements in interstate commerce when commodities are shipped

into states for resale where such contracts are legal. Manufacturers were now able to enforce price maintenance contracts both on an interstate and an intrastate basis in those states which had enacted legislation.

In 1951 the effectiveness of resale price contracts was substantially restricted by the Supreme Court in the *Schwegmann Bros. vs. Calvert Distillers Corp.* decision. The Court ruled that the Miller-Tydings law does not give immunity to non-signer arrangements. Only voluntary, signed resale price contracts, it held, are exempted from the Sherman Act.

The Schwegmann decision invalidated all resale price systems in interstate commerce which were based on the use of non-signer clauses. As a result in some areas, especially New York¹⁰ retail price competition became very intense.

The result was a campaign by retail trade associations to have the Federal legislation altered. In July 1952, Congress passed the McGuire Act which made permissible the use of the non-signer clause within a given state, in accordance with the legislation of the state, by manufacturers selling in interstate commerce.

But the rise of the large Discount houses during the early 1950's created new and costly problems for manufacturers

¹⁰ See E. Raymond Corey "Fair Trade Pricing: A Reappraisal", Harvard Business Review, XXX 5, pp. 47-62.

enforcing resale price maintenance. The Discount houses formed their own association to fight against wholesalers and manufacturers who refused to sell to discount houses, protesting that such action was in restraint of trade.

The non-signer clause was ruled unconstitutional by the Supreme Courts of thirteen "Fair Trade" states and in two other states the Supreme Courts held the entire "Fair Trade" act to be invalid.

The cost of policing price maintenance agreements became heavier as violations became more frequent. Manufacturers began to abandon their fair trade policy, particularly in the electric appliance industry.¹¹

In September 1955, the Westinghouse Electric Corporation, after six years of setting fair trade prices on its products, abandoned resale price maintenance. The General Electric Company, who had signed approximately 30,000 fair trade agreements with retailers and had policed these agreements aggressively finally abandoned resale price maintenance in February 1958. The expenditure of approximately one million dollars a year for the previous two years reveals the company's favourable attitude toward fair trade but at the same time the

¹¹ See Stewart Munro Lee "Problems of Resale Price Maintenance", Journal of Marketing, XXIII (January, 1959) pp. 274-280 for a more detailed account.

expenditure indicates how costly such a policy had become.

General Electric was followed one day later by the Sunbeam Corporation who felt they were forced to make the move in order to keep their dealers competitive in the electrical appliance market.

A contributing factor to General Electric's decision was a setback received in 1957 when the courts ruled that mail order sales from the District of Columbia, where there is no fair trade law, to New York at prices below those fixed under "Fair Trade" agreements in New York did not violate the New York fair trade statute.

The efforts of the electrical appliance industry to keep resale price maintenance reveals the change in attitude of manufacturers from the early history of the practice. Manufacturers appear to have become more aggressive than retailers in their efforts to retain price maintenance.

The strong growth of discount department stores coupled with the rising inclination of aggressive retailers to violate resale price agreements and risk or fight legal action, no doubt contributed to the decision of manufacturers to abandon resale price maintenance in the 1950's. It would appear that resale price maintenance plays an insignificant role in American marketing policies to-day.

Canada

Except for the last two decades there appears to be limited reference to resale price maintenance in Canadian journals. This may be a result of uncertainty about the legal position of the practice prior to 1951.

Resale price maintenance was concerned in a number of investigations under the Combines Investigation Act, but usually in conjunction with other restrictive practices.¹²

It was the only issue in one inquiry involving the Proprietary Articles Trade Association, an offshoot of a druggists' trade organization of the same name in Great Britain. In two reports published in 1926 and 1927 the conclusion was expressed that the public interest was detrimentally affected. The Proprietary Articles Trade Association was dissolved shortly after the final report was published.

A similar conclusion was reached in four other investigations under the Combines Investigation Act, tobacco 1938, dental supplies 1947, optical goods 1948, and bread in western Canada 1948.

An indication that resale price maintenance was becoming fairly widespread following World War II appears in the Report of the Royal Commission on Prices rendered in 1949 which states:

¹² See Report of Royal Commission on Prices II (Ottawa, 1949), p. 258.

Throughout our inquiry we have been impressed by the degree to which individual manufacturers fix the resale prices of their products and so narrow the area in which price competition amongst wholesalers and retailers is operative. In view of the extension of this practice, we recommend that the Combines Investigation Commission give careful study to this problem with a view to devising measures to deal with it.¹³

The same report reveals that Canadian consumers had become perturbed over the practice. The Canadian Association of Consumers and the National Council of Women presented a joint brief to the Royal Commission on Prices expressing concern over the growth of resale price maintenance.

The MacQuarrie Committee was appointed in June 1950 to study Combines Legislation. As a result of the recommendation of the Royal Commission on Prices, resale price maintenance was included as part of the study.

The Committee found it difficult:

to measure precisely the extent of resale price maintenance. The Committee, however, is satisfied that the practice of fixing resale prices is widespread, that it covers whole classes of goods, and that, if not quite as comprehensive as the United Kingdom, it is yet of significant and growing proportions.¹⁴

In its interim report on resale price maintenance

¹³ Report of the Royal Commission on Prices I (Ottawa, 1949) p. 41.

¹⁴ Resale Price Maintenance. An Interim Report of the Committee to Study Combines Legislation (Ottawa, 1951) p. 7

published in October, 1951, the Committee recommended "that it should be made an offence for a manufacturer or other supplier:

1. To recommend or prescribe minimum resale prices for his products:
2. To refuse to sell, to withdraw a franchise or to take any, other form of action as a means of enforcing minimum resale prices.¹⁵

As a result Canada became the first country to ban resale price maintenance unconditionally when legislation was enacted in December 1951. The Director of Investigation and Research was allocated the duty of investigating restrictive practices forbidden by the Act. The Restrictive Trade Practices Commission became responsible for examining evidence submitted to it by the Director.

An extensive public inquiry into loss-leader selling and the effects of abolishing resale price maintenance resulted in two reports¹⁶ published in 1954 and 1955 in which it was concluded that no new legislation was warranted for suppression or control of loss-leader selling.

Section 34 of the Combines Investigation Act which deals

15 Resale Price Maintenance. An Interim Report, p. 21.

16 (a) Loss-Leader Selling. Material Collected by the Director of Investigation and Research, Restrictive Trade Practices Commission, Ottawa, 1954.

(b) Report on an Inquiry into Loss-Leader Selling. *ibid.*, 1955.

with resale price maintenance was amended in 1960. Under the amendment a manufacturer can now refuse to sell to anyone who is using his product as a loss-leader, that is, not for the purpose of making a profit but for advertising or attracting customers to his store in the hope of selling them other articles. The manufacturer may also refuse to sell to anyone engaged in misleading advertising of his product or anyone failing to provide a level of servicing that purchasers might reasonably expect.

On examination this amendment might lead manufacturers to attempt to enforce some type of minimum price based on the interpretation of the word profit.¹⁷

Recent Developments in European Legislation¹⁸

Since the action of Canada to ban resale price maintenance, the governments of several European countries have taken measures to abolish or limit the use of resale price maintenance.

In 1953 Sweden enacted legislation making resale price maintenance subject to criminal penalties where permission is

¹⁷ See Report Concerning the Distribution and Sale of Electric Appliances, Electric Shavers and Accessory Products. (Sunbeam Corporation (Canada) Limited) Ottawa, 1962.

¹⁸ The following summary is drawn almost exclusively from O.E.C.D. Restrictive Business Practices, Comparative Summary of Legislation in Europe and North America (Paris, 1964).

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not granted by the Freedom of Commerce Board. In spite of wide legislative grounds for granting permission only three exemptions were granted between 1953 and 1962 and only recently one of these was withdrawn.

France adopted a similar attitude toward resale price maintenance in the same year. Prohibition of the practice is the rule and exemptions are the exception and are "very rarely granted".¹⁹

Denmark enacted legislation in 1955 which included a general prohibition of resale price maintenance unless special permission is granted by the cartel authority. Between 1955 and 1963 exemptions were granted to ten products.

Ireland has indicated a growing disapproval of the practice. Although no legislation has been enacted to prohibit resale price maintenance generally, six rulings were made prohibiting the practice in various trades between 1955 and 1962.

Germany joined the increasing list of countries legislating against resale price maintenance in 1957. The approach adopted has been more lenient than other countries with exemptions being rather numerous.

Norway by way of Royal Decree also became a member of the group of countries prohibiting resale price maintenance in 1957. Exceptions are allowed but have seldom been granted,

¹⁹ Ibid., p. 19

only three exemptions resulting between 1957 and 1961.

The increase in legislation directed at abolishing or limiting the practice of resale price maintenance appears to indicate an increasing doubt of the validity of arguments favouring acceptance of resale price maintenance. The next chapter is devoted to a consideration of the arguments more frequently encountered.

CHAPTER III

FREQUENT ARGUMENTS IN SUPPORT OF THE PRACTICE

In examining the most prevalent arguments in support of resale price maintenance the following point should be kept in mind:

When discussing the motives which induce distributors and manufacturers to support resale price maintenance, one has to take into consideration a source of error that is always present in cases where human interest are involved: the parties concerned tend to omit or under-emphasize the more selfish motives behind their actions and to make much of their concern for the public welfare. To obtain a true picture of the situation, it is, therefore, necessary to make a critical appraisal of the motives publicly stated and also to consider whether there may not be other motives as well.¹

A frequent argument in favour of resale price maintenance contends that it helps to keep the small independent retailer in business, thus ensuring an adequate number of outlets and preventing concentration of economic power. This result would be achieved because resale price maintenance requires all distributors to sell at a uniform price providing an adequate margin of profit for all.

Without resale price maintenance large department and chain stores operating at a lower unit cost are in a position to charge a lower price than the small retailer. The large

¹ Soren Gammelgaard, Resale Price Maintenance, (Paris, 1958) p. 36.

retailers are also in a favourable position to use the "loss-leader" device in order to attract more business and gradually eliminate the small retailers. In addition the large stores have control over their private brands and without resale price maintenance price cutting would occur only on products also handled by dealers whose volume of trade is already too small to enable them to carry their own brands. As a result of these advantages the larger outlets would increase their share of the market forcing the small retailer out of business.

The first presumption in the argument is that all small retailers should be protected from the price competition of large retailers, particularly the department and chain stores, or the small retailer will disappear.

There is no doubt that without the protection of resale price maintenance the chances of survival of the inefficient and marginal operators among the small retailers are greatly reduced.

Data in Table 1 indicates a tendency to larger retail outlets but at the same time would appear to suggest that the small retailer has continued to survive despite the banning of resale price maintenance in Canada.

Table 1

Percent Change in the Number of Selected Types of
of Retail Stores in Ontario 1951 to 1961*

<u>Types of Business</u>	<u>Percent Change</u>
Total Ontario	15.7
Tobacco stores and stands	-7.5
Books and stationery stores	60.0
Hardware stores	13.7
Household appliance stores	-8.7
Jewellery stores	10.8
Drug stores	5.0
Department stores	58.8
Furniture, T.V., radio and appliances	129.4

*Source: Census of Canada, 1961.

During a similar period in the United Kingdom the same tendency to larger retail outlets was present even though re-sale price maintenance was in effect. During this period from 1950 to 1961 the number of small retailers declined by 6,000² indicating that resale price maintenance does not necessarily protect the inefficient small retailer,

In Canada the greatest price competition in some instances has come not from the large department stores and chains but from the growing independent retailer who only a few years previous was a small retailer himself.³ The effect has been changes in retailing methods with resulting benefits for

² See "RPM - The Castle Tumbles", Economist (March 13, 1965) pp. 1157-58.

³ See Report on an Inquiry into Loss-Leader Selling. Restrictive Trade Practices Commission (Ottawa, 1955) pp. 49-52.

consumers.

The second portion of the same argument assumes that the concentration of economic power in the retail field is necessarily against the interests of the consumer.

Resale price maintenance has tended to appear in industries in which there are relatively few well established manufacturers with systems of national distribution. The situation approaches that outlined by J. K. Galbraith⁴ in which a market has been pre-empted by a few large sellers, entry of new firms has become difficult and existing firms have accepted a convention against price competition. Strong sellers, the manufacturers, in control of prices are opposed by weak buyers.

"In the typical modern market of few sellers the active restraint is provided not by competitors but from the other side of the market by strong buyers".⁵ The development of economic power by retailers will serve the interest of the consumer as the large retailers use their bargaining power to exert pressure on the margins of manufacturers. "Retailers are required by their situation to develop countervailing power on the consumer's behalf."⁶

⁴ John Kenneth Galbraith, American Capitalism, (Boston, 1956) p. 113.

⁵ Ibid., p. 112.

⁶ Ibid., p. 117.

Without resale price maintenance, price competition among distributors and the resulting reduction of gross profit margins will tend to give rise to increasing demands from all distributors that manufacturers reduce their prices to them. As price competition is likely to favour the larger and more active retailers, their bargaining strength as opposed to the manufacturer is increased making the possibility of obtaining a price concession from manufacturers more likely.

Two frequent arguments that are closely related are that resale price maintenance (1) prevents vertical integration and (2) protects the specialized retailer. By accomplishing the protection of the specialized retailer the reason for the need of vertical integration is also eliminated. The common basis for both arguments is the need for specialized selling and aftersale service for so-called technical goods - electric appliances, radios, television.

The argument states that without resale price maintenance competition will drive prices to such a level that retailers will not want to handle the product or will not provide the aftersale service which is required. Consequently manufacturers may decide to establish their own retail outlets to ensure proper aftersale service.

The protection of the specialized dealer is considered necessary to ensure an efficient system of distribution in the

field of technical goods. The consumer will receive no bargain if he should purchase an electrical appliance at a low price if it fails and he finds it impossible to obtain parts or service.

Canadian experience has disproved these arguments.⁷ In the electrical appliance industry in particular, servicing requirements have been much less than indicated. Some retailers have hired special service companies to carry out their servicing. In some of the larger centres manufacturers have established their own service centres. Pre selling by manufacturers and greater consumer knowledge have greatly decreased the need for specialized knowledge in selling.

Supporters have also argued that resale price maintenance prevents the use of monopoly power at the retail level and the resulting excessive prices. The basis of the reasoning is that without resale price maintenance prices of an individual manufacturer's product would vary in different localities dependent upon whether there was more than one dealer in its products. In small localities served by only one dealer, prices would tend to increase out of line with large communities where there are a number of dealers.

According to this argument, competitive conditions are

⁷ See Report on an Inquiry into Loss-Leader Selling. Restrictive Trade Practices Commission (Ottawa, 1955) pp. 112-123.

too readily assumed throughout the retail field. Each retailer has a certain amount of influence over a section of his clientele even if faced with a large number of competitors. This monopolistic aspect increases as the number of competitors decreases. One seller in a small community may have considerable monopoly power. With resale price maintenance however, monopoly power does not present any threat since maintained prices are maximum as well as minimum.⁸

This argument overlooks one of the main characteristics of retailing, the ease of entry. If a retailer is the only dealer in a community and charges excessive prices, the incentive exists to set up a competitive outlet, undersell the existing retailer and still obtain an adequate profit. In addition, the location of the community in relation to surrounding communities will be a limiting factor. Excessive prices may drive patronage to a neighboring community.

Another argument in the same vein is that resale price maintenance results in a more stable price structure and prevents excessive prices in both directions. The emphasis is on the retarding effect on the upward pressure of prices. In times of scarcity resale price maintenance is argued to prevent the charging of excessive prices with the resulting

⁸ Canadian legislation countered this argument by allowing suppliers to set a "maximum" resale price.

exorbitant profits.

Prices under a resale price system will be slower to move up or down for two reasons. First, the structure of the system itself will require infrequent changes. Frequent changes could result in loss of dealer and consumer confidence and would also make it difficult to coordinate advertising policies. Secondly, manufacturers margins are likely to be more than adequate and consequently less sensitive to cost increases.

In times of scarcity it is doubtful if the manufacturer will be able to maintain the price if pressure is strong. The retailer has other alternatives to increasing prices openly to obtain an increased return from the product. Under the counter transactions are difficult to detect and would require a great deal of policing on the part of the manufacturer.

This argument also assumes that price stability is desirable. Flexible prices are necessary to adjust to changing conditions of supply and demand. In times of shortage of supply price adjustment is the natural means of determining who will receive the available supply unless government intervention is warranted. Conversely when demand is low price cuts are desired in an effort to stimulate demand and maintain production and employment.

The most frequent argument advanced by the manufacturer is his need for protection by resale price maintenance from

the use of his product as a "loss-leader". Such use is alleged to damage the manufacturer's interests in several ways. It results in the loss of public confidence in the product. Because of the unprofitable price it may influence retailers to push substitute goods on which they can make an adequate profit. The "loss-leader" practice may lead to the loss of retail outlets to the manufacturer as retailers find it is not profitable to handle his product and discontinue stocking it.

The "loss-leader" is the most controversial aspect of the arguments concerning retail price maintenance. It is related to practically every argument submitted by retailer, wholesaler and manufacturer who support resale price maintenance. Consequently it has been given separate attention in the next chapter.

CHAPTER IV

THE LOSS-LEADER QUESTION

After first outlining the main arguments advanced to support the need of resale price maintenance to prevent "loss-leaders" this chapter will discuss the interpretation and definition of the concept of a "loss-leader". This will be followed by a rebuttal to the arguments and a summary of attempts or recommendations short of resale price maintenance which have been made with the view of controlling loss-leaders.

"Loss-leaders" it is maintained are products which are sold at a loss with the purpose of drawing customers to the retail outlet who will not only buy the loss-leader but also other articles carrying normal or high profits. The objective is to obtain profits from the sale of other commodities to new customers which will more than offset the loss resulting from the leader.

In some instances it has been said that this practice is actually unfair to the customer. The reasoning is that the prices of other goods must necessarily be higher than in other retail outlets in order to cover the loss of the leader.

It is further argued that unless their resale prices are maintained established brands in general demand will always be used as loss-leaders by some retailers. Resulting price

competition will force down the prices of the brand concerned throughout the market area to the same low level. Ultimately retail margins will be reduced to the point where dealers will no longer be interested in selling these brands. Manufacturers' sales will suffer both from the loss of retail outlets and the loss of customer confidence and goodwill. With all retailers prices at the same low level, those retailers who made the original price cut will have no further competitive advantage and will turn to new brands as loss-leaders.

Consequently there is a continual tendency to disturb the market of well-known brands. The manufacturers of these brands require resale price maintenance to protect their interests. The market fluctuations resulting from the use of branded products as loss-leaders will make steady production and sale of the goods impossible. In order to maximize economies in the production of branded goods resale price maintenance is necessary and therefore in the interest of consumers.

The basis of the loss-leader reasoning is open to criticism from two points of view. First, the very concept of a loss-leader has never attained an acceptable exact definition. Second, the required assumptions for price competition to result in the reasoned disruption of turnover and production are very precise with the consequence they are rarely found in practice.

The Canadian Restrictive Trade Practices Commission in

its inquiry into loss-leader selling found:

that a major difficulty in approaching the examination of practices alleged to involve loss-leader selling, is to obtain a clear description of the forms of selling which would unmistakably constitute such a practice, and not merely active price competition. Indeed a satisfactory definition is so elusive that a number of those appearing before the Commission stated that they did not know how loss-leader selling should be defined, or that there was no point in trying to define it, or that it cannot be defined.¹

The term "loss-leader" suggests the distinctive feature of an item sold at a price involving a financial loss. The problem arises in selecting a yardstick to separate loss-leader competition from ordinary price competition, that is to determine when prices involve a loss and when they do not.

In their inquiry the Restrictive Trade Practices Commission found that definitions submitted fell roughly into two categories "depending on whether the emphasis in the definition was in terms of the purpose of the price cut or whether it was in terms of the extent of the price cut".²

In the definition of loss-leader selling which gave emphasis to the extent of the price cut, the price below which it was argued an article could not be sold without being considered

1 Report on An Inquiry into Loss-Leader Selling, Restrictive Trade Practices Commission. (Ottawa, 1955) p. 7.

2 Ibid., p. 7.

a loss-leader, ranged through the entire scope from the manufacturer's suggested retail price to the lower of invoice or replacement cost.

As a result it becomes difficult to determine just what is really meant by "loss-leader" competition. The objective of all forms of competition is to obtain new customers, or keep old ones, with the view of raising or stabilising sales and increasing net profits.

According to economic theory, a specific price results in a loss to a retailer if he would be better off by not selling the product at all than by doing so at the price considered. Using this analysis a loss is suffered only if the purpose of the loss-leader is not realized. That purpose is to increase the total net profit of the retailer, the loss of the leader being more than offset by the profit on the increased turnover of other goods. Because of the close connection which sometimes exists between the sale of various merchandise in a store the purpose may be accomplished in spite of the fact that the leader is sold below its invoice cost to the retailer.

By the same reasoning it is apparent that retailers who use loss-leaders will not necessarily charge higher prices for other goods than their competitors.³ It is possible with

³ Ibid., pp. 95-101.

their prices of other goods equal to or lower than their competitor's prices that the net profit on the increased sale of those goods may exceed the loss on the leader. It is important to note in this respect that the operating costs of a retail outlet in the very short run may be considered in the most part fixed or overhead costs. Consequently the increase in costs resulting from a larger turnover will not greatly exceed the invoice price of the additional goods sold.

It is apparent that the usual criterion of economic theory to distinguish profitable from unprofitable pricing would not be applicable in separating loss-leader competition from ordinary price competition. Using principles of economic theory, loss-leader competition would include only those cases where the objective of using loss-leaders was not achieved, the profit on the increased turnover of other goods failed to cover the loss on the leader. Such results being viewed as tactical errors resulting in quick correction it cannot be against such incidents that the major claim to protection from loss-leader competition is raised.

Another definition frequently encountered is that loss-leader competition exists when the prices of leaders in isolation do not cover the cost involved in selling those leaders.⁴

⁴ See Soren Gammelgaard. Resale Price Maintenance. (Paris 1958) p. 49, and Report on an Inquiry into Loss-Leader Selling Restrictive Trade Practices Commission (Ottawa, 1955) p. 11.

The difficulty arises in determining the selling costs involved, as overhead costs are common to all goods sold. The distribution of overhead costs over the various articles of merchandise has no generally approved application. Goods sold in the same store contribute in an unequal degree to the covering of these costs. Therefore it would not be feasible to argue that loss-leader competition exists where goods do not contribute proportionally to the covering of overhead costs.

This suggests that in deciding which costs are involved in selling the leader we should disregard overhead costs. As practically all operating costs in the very short run are overhead costs, this definition then implies in practice that goods are only loss-leaders when they are sold below their purchase price. But this would require further qualification so as not to include perishable items sold below cost to limit loss, sales in trades with seasonal pricing where it is considered legitimate practice to sell goods out-of-season at strongly reduced prices; sales of bankrupt firms and clearance sales of old stocks.

A further definition would identify loss-leaders as articles sold with a smaller margin than other merchandise belonging to the same general category in the same store.⁵ But again

⁵ See Soren Gammelgaard, Resale Price Maintenance, *ibid.*, p. 50.

a problem arises in arriving at a standard. Some goods are of a distinctive nature allowing no comparison. Even where there is a basis for comparison, brands with a slower rate of turnover would carry higher margins than quicker-moving brands, if competition were totally free and were unaffected by restrictive influences or practices.

This definition is too inclusive, as it is not concerned with the absolute level of margins, but only with the relative level. As a result loss-leader competition would be identified as all cases where a brand is sold at a lesser margin than other brands of the same type of goods, whether a loss is suffered or a profit is gained.

Professor B. S. Yamey defines a "loss-leader" as "a 'leader' item which is re-sold below its trade price to the shopkeeper".⁶

It would appear that the definition of a "loss-leader" in order to be consistent with the literal term would include goods sold for a purpose other than contributing, in isolation, directly to the gross profit of the retailer. This would include all goods sold at or below invoice price to the retailer. Merchandise sold at invoice cost certainly will not contribute directly to the gross profit of the retailer and in

⁶ B. S. Yamey, Resale Price Maintenance and Shopper's Choice, (London, 1964) p. 27.

most cases would involve some loss on the sale in isolation of the goods concerned due to minimal handling costs for any merchandise carried. The definition should exclude goods sold at or below cost for the purpose of clearing end of season stock or broken and discontinued lines, or for the purpose of raising money to meet urgent cash requirement or disposing of stock of bankrupt firms.

It is apparent from the numerous surveys carried out by different governments that "loss-leader competition is all too often used to describe price competition which is coming from new types or methods of retailing.

It is difficult to see how the use of a "loss-leader" or any type of price competition can be unfair to the consumer as claimed. Lower prices are hardly a hardship on the consumer.

There no doubt have been instances where retailers have used leaders with the intention of trapping the gullible. The major use of the leader has been as a type of advertisement designed to attract customers to the retailers premises.

If the retailer has made a selective price cut(s) and left the remaining articles at competitive prices, customers are better off by the amount of the saving on the leader item.

Even if the retailer has raised the prices of other merchandise, a purchaser of this merchandise is only worse off if his increased expenditure on these articles is greater than

the saving on the leader.

But the argument of increased prices on other merchandise is contradictory in nature. On one hand we have a consumer who is sensitive to advertised bargains and yet on the other is not conscious of the competitive prices on other goods. This is very inconsistent behaviour when we consider the volume of price advertising plus many other methods of price comparison.

The Restrictive Trade Practices Commission in a survey⁷ involving grocery retailing found that in the three geographical areas surveyed the prices of other goods in the "loss-leader" stores were on the average four to seven per cent below the prices of identical goods in comparable shops which did not use "loss-leaders". Very few items showed any difference in the opposite direction.

In considering manufacturers' claims that their products will suffer loss of sales because of use as loss-leaders, the question arises as to what conditions would cause a result so opposed to accepted economic laws of supply and demand.

To attain the result claimed by manufacturers that price reductions by aggressive retailers in various locations will drive prices down to the same level everywhere, the demand for

⁷ See Report on an Inquiry into Loss-Leader Selling, Restrictive Trade Practices Commission, (Ottawa, 1955) pp. 97-101.

the product involved must be very sensitive to price differences. In addition, the knowledge of prices must be very general.

For a manufacturer to suffer unfavourable results from price competition among retailers it must be the retailer and not the consumer who decides which brands are sold. Only under this assumption would it be possible for sales to decrease when prices are reduced. This is contradictory to the basic economic reasoning that consumers buy more as prices are reduced.⁸

The argument of the manufacturer that prices of his brand will be forced down by competition between retailers to a point where many retailers will no longer be interested in selling his brand must be based on several assumptions. First, the price must be at or below the invoice price to the retailer. Secondly, the price must be kept at this point for a considerable period of time, not just for a few days or a week as in the case in special sales. Thirdly, the retailer is willing to risk loss of customers goodwill by not having available a widely advertised well known product.⁹ Fourthly, the retailer

⁸ Assuming levels of income and distribution of income are held constant.

⁹ The retailer may overcome this by stocking the manufacturer's product but not "pushing" its sale.

has a substitute brand on which the margin is adequate and which can in most cases be substituted for the dropped brand without injuring customer good will to any extent.

In their inquiry into loss-leader selling the Restrictive Trade Practices Commission concluded:

that sales below net purchase cost for the purpose of increasing the seller's general sales volume are made infrequently, and when such selling is engaged in it is generally for periods of short duration. The offering of goods in such a manner appears to result from active competition among merchants of comparable standing, and not from market domination by any one dealer or group of dealers.¹⁰

It would then appear the purpose served by selling below cost is to obtain effective advertising to attract customers to the store. The objective is an immediate stimulus to consumers, a bargain which is available for a limited time. The continual use of one item as a loss-leader would tend to exhaust its attraction and to establish the loss-leader price as the consistent price in the consumer's mind. The retailer using the loss-leader technique must find new bargains to maintain the effectiveness of his advertising and keep the consumer interest.

The manufacturer who argues that the retailer will drop his brand because of retail price competition must make the assumption that competitive brands will not be exposed to use

¹⁰ Report on an Inquiry into Loss-Leader Selling, Restrictive Trade Practices Commission (Ottawa, 1955) p. 262.

as loss leaders or to price competition. At the same time he must discount the effectiveness of his advertising and the popularity of his product.

If a retailer discontinues carrying a well established regularly advertised product he immediately supplies a perfect reason for any of his customers who wish to purchase the product to patronize his competitor.

The assumption that a suitable substitute exists for the discontinued stock must be based on the presumption that the substitute has a maintained price and therefore an adequate margin. This is inconsistent since without resale price maintenance all brands would be exposed to use as "loss-leaders" and to price competition.

A manufacturer will undoubtedly lose some dealers, the inefficient through their inability to survive and some who may eliminate his product from their merchandising policy. This does not mean his total sales volume expressed in units of product will fall.

The efforts of competitive dealers to maintain and increase sales and the resulting lower prices will be compelling factors leading to increased product sales volume for the manufacturer.

Manufacturers' arguments that sales volume will fall may be based on dollar sales volume and it cannot be denied that

dollar sales volume may fall if prices are pushed down far enough but product sales volume may increase nevertheless.

The measures proposed to eliminate "loss-leader" selling range from resale price maintenance to reliance on legislation which prevents the use of economic power to eliminate competition.

One of the most common proposals outside of resale price maintenance is for legislation to make any distributor liable to legal action if he should sell or advertise for sale any products as "loss-leaders". The action may be civil or criminal.

Loss-leader is defined as selling below cost where cost is defined as the price to the distributor plus a specified mark-up. Such proposals normally include an exemption for certain types of sales, legitimate clearance sales, sales of perishable or seasonal goods and goods sold under court order.

Legislation prohibiting the use of such loss-leaders in certain product lines was passed during the 1930's in three western provinces, Manitoba, Alberta and British Columbia. In each case the required mark up on total cost to the retailer was five percent. Similar legislation enacted in various states of the United States contain stipulated percentage mark ups ranging from six to as high as twelve percent.

The proposal of The Retail Merchants Association of Canada

Inc. to the Restrictive Trade Practices Commission recommended a mark up equal to "the distributor's or vendor's cost of doing business. In the absence of proof of the cost of doing business such cost shall be prima facie the lowest operating cost shown by the Dominion Bureau of Statistics' most recent report the type of classification of trade involved."¹¹

The adoption of any proposal stipulating a minimum required mark up establishes a lower limit for all retail margins. In the case of low margin items it may actually operate to increase prices.

Variations exist within any one establishment with respect to margins on different merchandise resulting from differences in handling costs and rate of turnover. In addition costs vary between retailers in the same line of business and possibly to a greater extent between retailers in different types of business handling the same product. Consequently such limitations of margins will hamper retailers in their attempt to market their merchandise most effectively.

American experience with such legislation in various states has indicated the limitations of such measures.¹² The

¹¹ Report on an Inquiry into Loss-Leader Selling, Restrictive Trade Practices Commission (Ottawa, 1955), p. 230.

¹² See Loss-Leader Selling, Material Collected by Director of Investigation, Restrictive Trade Practices Commission (Ottawa, 1954), pp. 279-85.

lack of interest in enforcement stems from the reluctance of retailers to file complaints or bring suits against competitors. Enforcement of such legislation by a government body would entail a tremendous administrative burden in policing the various prices concerned.

The 1960 amendment to the Canadian Legislation has returned the initiative to the manufacturer. The amendment reads:

(5) Where, in a prosecution under this section, it is proved that the person charged refused or counselled the refusal to sell or supply an article to any other person, no inference unfavourable to the person charged shall be drawn from such evidence if he satisfies the court that he and any one upon whose report he depended had reasonable cause to believe and did believe

(a) that the other person was making a practice of using articles supplied by the person charged as loss-leaders, that is to say, not for the purpose of making a profit thereon but for purposes of advertising;

(b) that the other person was making a practice of using articles supplied by the person charged not for the purpose of selling such articles at a profit but for the purpose attracting customers to his store in the hope of selling them other articles;

(c) that the other person was making a practice of engaging in misleading advertising in respect of articles supplied by the person charged; or

(d) that the other person made a practice of not providing the level of servicing that purchasers of such articles might reasonably expect from such other person.¹³

¹³ Combines Investigation Act, Revised Statutes of Canada (Ottawa, 1960) Part V, Section 34(5). See Appendix.

This amendment now gives the manufacturer a basis for establishing a minimum resale price. This price would consist of the cost of the product to the retailer plus a stipulated mark-up which the manufacturer has "reasonable cause to believe" to be necessary if the product is to be sold at a profit.

In other words it is the manufacturer who now defines the "loss-leader". As a means to maintaining his minimum resale price it appears the manufacturer can now legally withhold supplies.

An excellent example of this is revealed in the Report of the Restrictive Trade Practices Commission on an investigation into the distribution policies of the Sunbeam Corporation (Canada) Limited.

Commenting on the passage of the amendment one of the company's executives in a letter to the president of the parent American company writes:

In the meantime we are making certain investigations with some of the local economists and statisticians to try and obtain as much information as we can about average profits by most electric appliance retailers in an effort to have some basis on which we can justify our refusal to sell these fellows who are loss-leadering. All we have to have is reason to believe they are doing this and any accurate statistical information that we have can be used as a basis.¹⁴

¹⁴ Report Concerning the Distribution and Sale of Electric Appliances, Electric Shavers and Accessory Products (Sunbeam Corporation (Canada) Limited) Restrictive Trade Practices Commission (Ottawa, 1962), p. 14.

Subsequently the company embarked on a marketing program designed to "establish minimum profitable resale prices for dealers".¹⁵ This resulted in an enquiry by the Director of Investigation and Research under the Combines Investigation Act with the evidence and argument being presented to the Restrictive Trades Practices Commission in June, 1962. At the time of writing a decision is pending on the Court action which resulted from the investigation.¹⁶

The time consuming procedure involved in bringing such actions to court must operate to the benefit of the manufacturer's marketing plan. Supplies have been effectively withheld from retailers concerned for a lengthy period with its implications to the remaining dealers.¹⁷

The only effective method which appears open to the retailer under this legislation is to submit proof to the distributor or manufacturer that his average cost is less than the minimum mark-up stressed by the manufacturer. It would

15 Ibid., p. 16.

16 The decision will not be available until after a decision is rendered on the constitutionality of resale price maintenance in a case brought by Mr. Cooper Campbell of Toronto contending that Section 34 (2) (B) of the Act (see Appendix A) is ultra vires on the grounds that the section contravenes the constitution.

17 The possibility exists under the Act for the retailer to obtain an injunction preventing the manufacturer from withholding supplies but it has not been used.

appear that retailers are reluctant to reveal their financial books to manufacturers and in any case accounting differences would undoubtedly contribute to disagreements on the statements submitted.

Even if the retailer were to establish his average costs as lying below the minimum mark-up believed by the manufacturer to be profitable it would appear he would still be required to mark-up the product the amount of his average cost. As mentioned previously mark-ups on various items handled by a retail outlet can vary considerably depending on handling costs and rate of turnover. Consequently the mark-up on low margin items would be increased under this method.

It appears that any legislation designed to control or eliminate "loss-leaders" will be open to criticism. The fact that the concept of a loss-leader is not precise but has a wide range of meanings to various people may be an insurmountable obstacle. The establishing of a minimum mark-up creates a barrier which competitive forces are prevented from possibly passing.

The banning of sales at or below net cost to the distributor would protect the manufacturer from the obvious case where his product is being used for advertising. But even this legislation would require qualification for certain special sales. Indications are that sales at or below cost are

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relatively rare and consequently such legislation would be of little value.¹⁸

The use of legislation designed to control measures aimed at eliminating a competitor¹⁹ would appear adequate to deal with any cases of grave loss-leading.

In Chapter II it was noted that the early organized movements to obtain resale price maintenance originated with the independent small retailers who have continued to support the practice. In the next chapter an attempt is made to determine the possible reasons which motivate the small retailer in his support and to assess the economic effects of resale price maintenance on the distribution system.

18 See Report on an Inquiry into Loss-Leader Selling, Restrictive Trade Practices Commission (Ottawa, 1955) p. 262.

19 See Appendix A, Section 33A, B & C.

CHAPTER V

THE ECONOMIC EFFECTS OF RESALE PRICE MAINTENANCE AT THE DISTRIBUTION LEVEL

Although it is the manufacturer who operates a system of individual resale price maintenance the initiative does not always come from this source. Soren Gammelgaard found "that more often than not it is the retailer and their trade association who induce the manufacturers to adopt this method of price fixing".¹

B. S. Yamey writing about the origins of resale price maintenance in the United Kingdom states:

"With perhaps a few exceptions, the story of the beginnings of r.p.m. is that of the activities of organized bodies of shopkeepers, operating on traditional lines with the provision of more-or-less elaborate services at relatively high costs, seeking to induce manufacturers of branded goods to protect them against the competition of other retailers willing and able to work on lower gross margins and to sell at lower retail prices, because of their greater efficiency or their less extensive retailing services."²

It was through the aggressive campaigning of the retail and wholesale trade organizations in California that the first "Fair Trade" legislation was passed in 1931 in the United States.

1 Soren Gammelgaard, Resale Price Maintenance, (Paris, 1958), p. 35.

2 B. S. Yamey, Resale Price Maintenance and Shopper's Choice, (London, 1964), p. 11.

Regardless of what arguments may be forthcoming retailers and wholesalers will favour resale price maintenance over no price maintenance only if there is some economic benefit to be obtained. In order to induce business men to adopt the practice, resale price maintenance must result in higher or safer profits or at least be thought to do so.

The primary concern of the retailers who support resale price maintenance must be protection of profits, the maintenance of the "status quo". Resale price maintenance assists the established retailer in keeping his segment of the market.

The monopolistic elements which determine the individual retailers market in the absence of price competition are primarily of a spatial and personal nature. The convenience of location, shopping habits, treatment in the past, preference for the retailer, his staff and amenities are all factors which assist in holding more particularly the patronage of the small retailer.

The consumer is unlikely to be tempted into changing his shopping pattern unless some relatively substantial benefit is to be obtained. Resale price maintenance tends to eliminate the most potent attraction, lower prices.

It may be argued that the consumer could be attracted by a low price on goods which do not have resale price maintenance. But this will depend upon the prevalence of resale price

maintenance.

Where only a few products have maintained prices it may prove effective but where resale price maintenance is generally prevalent price cuts on non-maintained articles would have to be relatively substantial. In either case the consumer may end up by buying less expensive articles at the competitive retail outlet and the price maintained articles from the small retailer. Also, the general prevalence of resale price maintenance may contribute to the consumers' acceptance of the prices of the small retailer on non-maintained articles.

Resale price maintenance thus tends to maintain the influence of location a small retailer has over his market. Encroachment by competitive retailers is hampered because they are limited in their use of price competition.

In addition resale price maintenance makes the entry of new retailers into an established market more difficult. The most effective method available to the new retailer to attract customers to his premises is the offer of lower prices. The more widespread the use of resale price maintenance the more difficult it is to use this method to establish a required volume of trade. The practice thus affords the small non aggressive retailer some protection against both established and new competitors.

Individual resale price maintenance could be used as a

round about method of obtaining a horizontal price agreement among retailers. Should a group of retailers tacitly agree among themselves that they wish to maintain the price of an article this objective can be attained by persuading the manufacturer to implement a program of resale price maintenance. It is actually more effective than a horizontal agreement as the manufacturer will have means of disciplining those who do not adhere to the price.

The elimination of price competition by the general use of price maintenance affects retailing methods and techniques and most important, retailing costs. Competition is not ended even if all merchandise handled is price maintained. Resale price maintenance eliminates the most effective tool of competition and drives competitive energies into other channels. The resulting diversion of competition away from competitive price reduction tends to increase the amount of resources devoted to the provision of retail services.

Price maintenance does not eliminate the possibility of modifications in the structure of retail trades, but generally works in favour of established firms by retarding change and by eliminating price competition, the most effective instrument of change.³

With price competition abolished or limited in effect, non-price competition increases. Since a retailer cannot

³ B. S. Yamey, The Economics of Resale Price Maintenance (London, 1954), p. 87.

increase his sales by striving to reduce costs and prices, competitive effort tends to result in cost increases through larger expenditures on advertising, attractive store furnishings and displays, easy credit, free delivery services in attempts to stimulate buying. Resale price maintenance diverts effort from cost-decreasing measures while promoting cost-increasing systems of selling. The consumer is denied the benefits of lower costs and the choice of variations in service.

It is easy for the consumer to decide where to buy when identical articles are sold at a lower price in one store than in another particularly as the lower price outlet will be sure to publicize its advantage. Customers can also calculate the amount of saving achieved by switching to a new source.

But with price maintenance it becomes much more difficult in deciding on the best buy. It becomes difficult to determine which retailer offers the greatest advantage in services such as credit, free deliveries, after sale service to mention a few. Retailers will undoubtedly advertise the advantages of their services but the similarity of claims and the vagueness of differences will hamper customers' decisions. Personal visits to enable close examination may supply more information but the customer will still not be able to gauge in terms of money which offers the greatest value.

Resale price maintenance prevents the retailer from selecting his own individual combination of price, service and sales promotion. As a result the consumers liberty of choice between patronizing a store with low prices and a minimum amount of service and sales effort or patronizing another outlet with higher prices and more impressive service is removed or limited.

That some of the additional service resulting from resale price maintenance is of value to the consumer is indisputable. But the relevant point is that some consumers would prefer lower prices over better or increased service.⁴ Resale price maintenance forces them to pay for service they would rather

⁴ "Many shoppers are helped by suitably trained and experienced sales staff and by being able to choose from a wide range of goods. Helpful and competent staff and wide and varied stocks are costly. These costs can be largely avoided by retailers who let the goods sell themselves and who limit their stocks to a narrow range of items which are best sellers. It would be ideal if the two types of shop could flourish side-by-side, the proportions to be settled by the preferences of shoppers. It is conceivable, however, that the two types of shop could not co-exist so long as they are able to charge different prices for the same goods. It is arguable that some shoppers may make use of the excellent services and selections in a shop of the first type, and decide what they want to buy. They may then go to a shop of the second type and buy the items they want.... Thus they can buy at the lower prices, after availing themselves (without cost to themselves) of the expensive services of the first shop. It follows that shops of the first type would tend to go out of business.... The consumers would be worse off;..." B. S. Yamey, Resale Price Maintenance and Shopper's Choice (London, 1964) p. 20. Although Yamey presents the soundest counter-argument to this point we could discover, he is not convinced of its validity.

do without. Moreover as the consumers who would most prefer lower prices to additional service are to be found principally in the lower-income groups, resale price maintenance may be said to discriminate more particularly against this group.

The sensational success of the cash and carry discount store in both the United States and Canada has illustrated that a large group of consumers from all classes are prepared to forego extensive retail services or to break established habits of shopping under the stimulus of price reductions.

B. S. Yamey is assessing the effect of resale price maintenance in the United Kingdom writes:

The denial to consumers of the effective choice between more elaborate and less elaborate services has inhibited the development of retailing methods which provide goods cheaply but with austere service...⁵

In the short run resale price maintenance will prevent the competitive retailer from reaching his most efficient level of operation. In the long run resale price maintenance will hinder the development of economies of scale in retailing.⁶

The short run objective can be obtained by increasing the turnover of stock to its most efficient point. The long run objective will be attained by increasing both the volume

⁵ B. S. Yamey, The Economics of Resale Price Maintenance (London, 1954) p. 74.

⁶ See L. A. Skeoch, "The Abolition of Resale Price Maintenance: Some Notes on Canadian Experience" Economica, August 1964, pp. 268-9.

of stock and the rate of turnover to their most efficient points. Both objectives require expansion of the retailers sales, differing only in the degree of expansion. This can only be obtained by either stimulating demand in his segment of the market or by extending his spatial market or more likely by a combination of both.

The effective method of accomplishing this is by offering lower prices. The more substantial the reductions a retailer can offer the greater will be the area from which he can attract customers. To the consumer the saving must warrant the additional time and travel involved plus the inconvenience in changing shopping habits.

Soren Gammelgaard in commenting on this aspect writes:

Mail order houses, chain stores, department stores, consumer co-operatives, super markets, voluntary chains, self-service shops, discount houses, and other new types of trading establishments have made their way to a large extent by selling more cheaply than ordinary shops, and they have generally been against resale price maintenance, at least during their formative years. The fact that those forms are, as a rule, less developed in Western Europe than in the United States may have several causes, but the greater extent of resale price maintenance in Europe may be one of them.⁷

The uniform and inflexible price structure resulting from resale price maintenance prevents distributors from seeking

⁷ Soren Gammelgaard, Resale Price Maintenance, (Paris, 1958), p. 66.

out more efficient distribution methods. Besides being denied his own individual choice of price and service to be offered the consumer, the distributor is prevented from changing or differentiating his prices in such a way so as to influence customers "to make purchases at those times, in those quantities and packages, and on those terms of delivery which incur the lowest costs for both parties".⁸

Resale price maintenance tends then to hamper both the development of more efficient retailing methods and the expansion of the existing efficient outlets by removing the most effective tool, price competition.

When a program of resale price maintenance is instigated and more particularly when the initiative has come from retailers there will be a strong tendency to establish high margins. As the manufacturer will desire to obtain the widest possible distribution for his product it is extremely likely that he will fix margins at a level to allow a profit to high cost retailers.

The combination of potential high profits plus security from price competition will tend to attract new entries into the branches of retailing with general price maintenance. This will tend to reinforce the tendency to "excess capacity" which

⁸ Ibid., p. 67.

prevails in retailing as a consequence of the ease of entry.

Thus resale price maintenance contributes in two ways to the inefficient use of resources in retailing. First by diverting competitive energies from price competition into advertising and service competition it leads to undesired use of resources. Secondly, by attracting new retailers to the scene it reinforces the tendency to "excess capacity" and the resulting inefficient use of resources.

Competitive retailers may try to counteract the limitations on price competition imposed by resale price maintenance by introducing their own brands. But the products which are price maintained are usually produced by well established firms who have built up strong consumer preference. This fact may make it a lengthy and costly procedure to establish acceptance and push the sale of a private brand. Even where this is done successfully the effect of price competition is lessened because of the difficulty faced by consumers in assessing whether the difference in price reflects a 'better buy' or a variation in quality. The price level of the price maintained brand will in the same vein influence the pricing of the private brand.

While retailers have been far more active than wholesalers in persuading manufacturers to adopt resale price maintenance, wholesalers have generally actively supported the retailers

in their demands.⁹

The wholesalers motive is similar to that of the retailer, the protection of profits and possible higher profits. In addition, the survival of the smaller independent retailer is imperative to the continued existence of the wholesaler.

The growth of large retail organizations to the point where their bargaining power enables them to buy direct from the manufacturer threatens the very function of the wholesaler while exerting pressures on his price structure. Consequently wholesalers will be influenced to join forces with retailers in demanding resale price maintenance in order to hamper the development of economic power among the larger retailers.

The effects of resale price maintenance on the function of wholesaling will be similar to that on retailing. Competitive forces will be diverted from price competition to competition in services. The development of more efficient methods will be retarded and there will be a tendency for new entries to be attracted into the field because of higher margins and security from price competition.

Resale price maintenance increases distribution costs initially and subsequently impedes the development of cost reducing methods. By removing the spur of price competition it

⁹ See V. A. Mund, Government and Business, (New York, 1955), p. 464.

slows down the pace of change in the distribution system.

The greater the difference in trading methods in use at any one time, the greater the importance which must be attached to a speedy replacement of less efficient firms and methods by more efficient ones, and the greater become the retarding effects of resale price maintenance.¹⁰

Besides restricting the efforts of the competitive element of the distribution system resale price maintenance penalizes the consumer. Not only is the consumer required to pay higher prices he is given no voice in deciding the amount of distributive costs he may wish to pay.

The retailer is restricted on one hand from offering a choice of alternatives between services and price and on the other the consumer is restricted from making his choice and thus influencing changes in the structure of retailing.

¹⁰ Soren Gammelgaard, Resale Price Maintenance, (Paris 1958), p. 67.

CHAPTER VI

WHY MANUFACTURERS MAY DESIRE RESALE PRICE MAINTENANCE

In the early history of resale price maintenance it was the small traditional retailer who advocated and campaigned for the adoption of the practice while manufacturers were somewhat reluctant to act. More recently, particularly since the end of World War II, it has been the manufacturer who has made greater efforts to establish programs of resale price maintenance and who has been its most active supporter. An excellent example has been the efforts of electrical appliance manufacturers in both the United States¹ and Canada².

In determining the motives which may induce manufacturers to advocate resale price maintenance it has already been indicated that the desire of dealers and their association for its adoption may be sufficient reason for the manufacturer, as their earnest support is obviously to his benefit. But all retailers are not normally in favour of resale price maintenance so the manufacturer will lose some support whatever

1 See Stewart Munro Lee, "Problems of Resale Price Maintenance", Journal of Marketing XXIII, (January, 1959) pp. 274-280.

2 See Report on an Inquiry into Loss-Leader Selling, Restrictive Trade Practices Commission (Ottawa, 1955) p. 225.

course he adopts.

On first examination, resale price maintenance would appear to be against the interests of the manufacturer. The objective of the practice is to set the price at a minimum or fixed level. Once the factory price is established it would be assumed that the manufacturer would generally desire to have his product resold at as low a price as possible so that the largest possible number of consumers could afford to purchase the product. The smaller the resale margin, the larger - other things being equal - the profits of the manufacturer as his sales increase.

But price is not the only factor affecting the consumer's decision, particularly when there is a difficult comparison between a diversity of brands carrying various prices. The manufacturer may find it more beneficial to invest in sales promotion and sell at somewhat higher prices. The sales promotion may involve the use of advertising in an effort to try and persuade the consumer in advance to ask for his brand or it may involve an attempt to influence the consumer at the very moment of purchase, or more likely, a combination of both. The effective method of influencing the consumer at the moment of purchase is to supply retailers with an incentive to make a special sales effort in favour of the manufacturer's brand. Resale price maintenance may appear as an aid to the

manufacturer in making both types of sales promotion effective, but particularly the latter.

The tendency then will be to set the margin high in order to ensure stocking of the product by even the high cost retailer and also to supply a strong incentive for preferential treatment of the product by retailers.

The manufacturer who adopts a resale price will certainly still be guided by rational motives in his selection. The price will be selected on the basis that it will likely give the manufacturer the maximum profit in the long term.

But a manufacturer will not be inclined to adopt the practice unless it is likely his competitors will do the same. If he should adopt resale price maintenance while his competitors do not his product becomes extremely vulnerable to price competition at the retail level with the implications for his share of the market.

In a trade where the sellers are kept fully and promptly informed about the price-decisions of their rivals, it may happen, as has been seen, that price-fluctuations will be damped down because of prudent individual calculation and without collusion. In a price-leadership situation this result occurs not because of the mutual caniness of the more-or-less equal competitors but because one seller has a predominant position, which others, if they are prudent, will not see fit to challenge.³

³ A. D. Neale, The Antitrust Laws of the United States of America, (London, 1960) p. 53.

If the manufacturer is the dominant firm in the industry and particularly if he has attained some cost advantages he may be in a position to adopt resale price maintenance with the result that other firms in the industry follow his lead.

In an industry where competitors are relatively equal in power and resources the desire to adopt resale price maintenance must usually be industry wide. Even though the incentive may come from strong retail organizations some agreement, tacit or formal, is highly likely between manufacturers prior to its adoption.

Although resale price maintenance is first and foremost a method of abolishing price competition among dealers it can also be a means of abolishing or restricting competition among the producers themselves and this may sometimes be the manufacturer's chief motive in adopting the system.⁴

Resale price maintenance tends to find support in industries where there are relatively few companies, large in size, producing well established products. With the combination of resale price maintenance on an industry wide basis and relatively few but large manufacturers, retail prices will tend to settle at a common level either through agreement or price leadership.

Price competition having been eliminated at the retail level it has been argued that price competition will take place

⁴ Soren A. Gammelgaard, Resale Price Maintenance, (Paris, 1958) p.42.

at the manufacturers' level. In other words the individual manufacturer will tend to compete by offering a larger margin on his product thus leading the retailer to promote his brand more aggressively than a competitor's brand.⁵

But if one manufacturer increases his margin this can only result in pressure by retailers on the remaining manufacturers in the industry to match or surpass the increase. The net result would tend to be a decreased return to all manufacturers because of the increased margins.

The action of wholesalers will follow a similar pattern.

As a result of the pressure from distributors or of foreseeing the possibility of this pressure, the self interest of the manufacturers through agreement or price leadership will lead to uniformity of margins at the wholesale and retail level with the resulting uniformity in factory prices. With price competition eliminated at all levels, the division of the market among the brands is left to depend upon such factors as the reputation of different brands and the success of sales promotion efforts.

The desire for resale price maintenance by an industry may be the result of a horizontal agreement among manufacturers.

⁵ Manufacturers may argue that margins will tend to be reduced because of price competition at the retail level when prices are established. Supra. pp. 69-70 for rebuttal.

Price competition at the retail level would tend to disrupt the complete plan and make it unworkable.

Another motive may be compensating protection for both manufacturers and retailers. Manufacturers protect dealers from price competition by establishing a program of resale price maintenance. The retailers, in return protect the manufacturers through tacit agreement to purchase only from them and not to buy from manufacturers without maintained prices. This affords the manufacturer protection particularly from new entries into the industry and those using competitive selling methods.

The manufacturer may see in resale price maintenance a method of keeping a favourable bargaining position. Under the system it is the manufacturer who sets the price and margins for his product, ensuring demand by use of advertising and other sales promotion methods. With his product distributed through a large number of outlets, small and large, and a substantial margin, he enjoys relative freedom from pressure by retailers for price concessions, more particularly if agreement or price leadership exists in the industry.

Without resale price maintenance, price competition among retailers will lead to constant pressure on their margins which, sooner or later, will result in pressure on the manufacturer's prices and margins also. Since price competition is likely to

favour some of the larger and more aggressive retailers their bargaining strength will increase with their sales.

The development tends to follow closely that outlined by J. K. Galbraith in his "Theory of Countervailing Power".⁶ Industries desiring resale price maintenance tend to have characteristics of a few large sellers protected by difficulty of entry and having accepted a convention against price competition. "Power on one side of a market creates both the need for, and the prospect of reward to, the exercise of countervailing power from the other side."⁷

Where no resale price maintenance exists, the large retailer may by aggressive price competition along with improved merchandising methods obtain a substantial segment of the retail market for a product. In the case of a chain store or a department store, the share attained might be an important portion of the individual manufacturer's production.

By threatening to buy elsewhere or to enter the manufacturing field the retailer may be able to gain substantial price concessions from the manufacturer who wishes to protect an efficient production schedule.

The purpose of adopting resale price maintenance may be designed to forestall or prevent such development of economic

⁶ John Kenneth Galbraith, American Capitalism, (Boston 1956) pp. 108-34.

⁷ Ibid., p. 113.

power by retailing organizations. Through its use the manufacturer is able to obtain wide distribution through many outlets thus preventing or hindering the concentration of retail sales with the large retailers.

Resale price maintenance may actually be more effective in controlling the large retailer than his small competitor.⁸

Small distributors generally can get away with a fair amount of price cutting, but large distributors are under careful surveillance by the manufacturers and rival retailers. Thus resale price maintenance tends to favour the small distributor in two ways: he cannot be undercut by the large distributor, and he is left considerable room in which to undercut the large distributor.⁹

The manufacturers motive for desiring resale price maintenance must be either to obtain an increased profit or to protect the present level of profits. It would appear that he is afforded the opportunity to do a little of both.

If there is a tendency to a horizontal agreement or price leadership in the industry, a price approaching the monopoly level may be placed on the product with efforts directed at establishing it as acceptable through constant advertising associating the price with high quality.

There may be some tendency to a waste of resources as a

⁸ See E. R. Corey "Fair Trade Pricing: A Reappraisal", Harvard Business Review XXX, (September, 1952).

⁹ Alfred R. Oxenfeldt, Industrial Pricing and Market Prices, (New York, 1951) p. 429.

result of the legal and other costs of policing and enforcing a system of resale price maintenance.¹⁰ Constant policing will be required if the system is to be effective and where violations are encountered legal costs will be incurred on both sides.

Finally, with the bargaining power of the large retailer effectively checked and where the spur of price competition is not effective the incentive to pass on any cost savings resulting from technological advancement or increased volume to the consumer is very limited. Such economies are likely to result in the increased allocation of resources to sales promotion efforts with the objective of increasing the market share.

¹⁰ See Stewart Munro Lee, "Problems of Resale Price Maintenance". Journal of Marketing XXIII (January, 1959) pp. 274-280.

CHAPTER VII

CONCLUSION

The purpose of this discussion has been to attempt to establish whether resale price maintenance does or does not serve the public interest. In assessing the practice the two major considerations have been the implications for the consumer and for the efficiency of the economic system.¹

The history of the origins of resale price maintenance indicate a similarity in early development in the United Kingdom, the United States and Canada. The threat of new types of retail outlets to the position of the small traditional retailer forced him to seek methods of counteracting this competition.

Department and chain stores were cutting into the trade of the small retailer through price competition. The increase of branded and trade-marked merchandise contributed to further competition across product lines. As a means of improving their competitive position small retailers joined together to form trade associations which proceeded to negotiate with manufacturers and to persuade some to adopt resale price

1 Within the limitations and qualifications regarding restrictions on competition and price competition mentioned above. Supra., p. 4.

maintenance.

In the United Kingdom the practice became fairly widespread, having been estimated to amount to thirty percent of the public's expenditure on consumer goods in 1938.² There was no legislation dealing with resale price maintenance until 1956 when horizontal resale price agreements were ruled illegal.

Individual resale price maintenance was finally prohibited with the passing of "The Resales Prices Act" in 1964. Suppliers of goods were allowed to apply for exemption from the statutory prohibition with the provision that resale price maintenance could be continued until the court rendered a decision. A substantial number of applications were submitted and despite the fact that an increasing number of applications are being withdrawn it appears it may be several years before the Court renders decisions on the many applications remaining.³

In the United States the period prior to the 1930's was notable for the uncertainty of the legal position of resale price maintenance. The practice was first made legal for intrastate commerce in California in 1931. The passage of the Miller-Tydings Act in 1937 legalized resale price maintenance in interstate commerce where commodities were shipped into

² See Report of the Committee on Resale Price Maintenance (Lloyd Jacob Report) (London, 1949) p. 1.

³ See the Economist July 3, 1965, p. 58.

states where it was legal under state law. Within two years the number of states with "Fair Trade" laws increased from fourteen to forty-five.

The Schwegmann decision in 1951 invalidating the "non-signer" clause caused a collapse of resale price maintenance in interstate trade and severe price competition developed. The McGuire Act of the next year restored the "non-signer" clause but the reprieve for the practice was only temporary.

The increasing abundance of goods and the resulting sharpening of competition contributed to increasing violation of resale price maintenance. The evolution of the large discount store offering a wide variety of merchandise on a cash and carry basis was a major factor in the increasing competition.

The large discount stores in order to develop the required market cut prices substantially on a large cross section of merchandise involving also price maintained articles. This coupled with price cutting by some small retailers on price maintained goods forced the large chains and department stores to put constant pressure on manufacturers to discipline the price cutters. The resulting heavily increased costs of policing resale price maintenance agreements ultimately induced a large number of manufacturers to abandon the practice. Although some resale price maintenance still exists in the United States the practice does not appear to be significant in

distribution policies.

In Canada, resale price maintenance attracted little attention or comment prior to World War II although in two investigations it was found that it was detrimental to public interest. The uncertainty of the legal position of resale price maintenance during this period may account for the infrequent reference to the practice.

Following World War II the use of resale price maintenance increased leading to the investigation of the MacQuarrie Committee. As a result, in December, 1951, the practice, and any attempt to enforce it, were made illegal. In 1960 an amendment was passed which allows a manufacturer to refuse to sell to anyone who uses his product as a loss-leader, which is defined as selling the article not for the purpose of making a profit but for the purpose of advertising or of attracting customers to his store. Sales may also be withheld if the dealer is making a practice of engaging in misleading advertising in respect of the product or failing to provide the level of servicing that purchasers might reasonably expect.

This amendment tends to weaken the legislation as manufacturers appear to be now in a position to exert some pressure on retailers in an effort to establish a minimum retail price. Although designed to eliminate the "loss-leader" complaint it does not appear to have been sufficient in view of the Canadian

Appliance Manufacturers Association's plan to present a brief to the government later this year requesting "some pricing control".⁴

Although developments in all three countries have followed somewhat different paths, the apparent destinations appear to be the same, the eventual elimination of resale price maintenance. Canada, as a result of a recommendation from an investigation into increasing prices,⁵ conducted a public inquiry into the practice leading to its banning in 1951. The United Kingdom legislation of 1964 similarly resulted from public enquiries into the use of the practice. The gradual abandonment of its use in the United States appears to have been caused in part by the increasing aggressiveness of both new and old retailers⁶ and in part by the differences and inconsistencies of Federal and State Legislation.

Resale price maintenance originated with the small retailers' efforts to gain protection from the price competition of new types of retail outlets. This has continued to be the prime motive of that segment of the retailing industry which

⁴ See "Some Pricing Control Will be Requested by Appliance Manufacturers". The Globe and Mail, August 6, 1965, p. B1.

⁵ See Report of Royal Commission on Price, I, (Ottawa, 1949), p. 41.

⁶ See L. A. Skeoch, "The Abolition of Resale Price Maintenance: Some Notes on Canadian Experience", Economics, August 1964, p. 269.

has continued to support the practice.

Resale price maintenance also may afford retailers a means of obtaining a horizontal price-fixing agreement where manufacturers are willing or can be persuaded to require that their product be sold by all retailers at the same price. It is actually more effective than a horizontal agreement among retailers because of the ability of the manufacturer to take action against violators of the agreement.

The practice tends to restrict competition at the retail level with its implications for the consumer and for the use of resources. Its effects upon the structure of retailing tend to be retardative in nature.

Resale price maintenance protects the non-aggressive retailer, particularly the inefficient and marginal operator, and increases the costs of distribution by the tendency to increase service costs, to increase excess capacity in retailing and to hamper the evolution of more efficient retailing methods and economies of scale in retailing establishments.

With price competition prevented or limited by the practice, competitive energies are directed into advertising and service channels with a resulting increase to retailing costs. Easy credit, free delivery, elaborate store furnishings, costly displays are all used in varying degrees in an effort to stimulate buying.

The high margins resulting from the manufacturers' need

to provide a profit to high cost retailers, with their suggestion of an opportunity to earn better than average profits will tend to draw new entries into retailing. This will reinforce the tendency of the retail industry to develop "excess capacity" as a result of ease of entry.

The elimination of price competition removes the major incentive to the development of less costly retailing methods. The retailer is prevented from using any savings effected by more efficient methods to reduce prices with the view of expanding his sales in an effort to gain further reductions of costs. He is precluded from varying his margins in an effort to find the turnover which produces the maximum profit. By losing the use of price competition both to stimulate demand and to extend his spatial market the retailer is hampered in attaining economies of scale over the long run.

The growth of economic power in the retailing field should not be a concern unless it is likely to result in a tendency to monopoly. The present trends in retailing do not indicate any such tendency in view of the continued survival of the small retailer and the keen competition between the various types of retailing.⁷

⁷ See John Kenneth Galbraith, American Capitalism, (Boston 1956), p. 118 for a discussion of the position of the large retailer.

The threat from economic power in retailing to the manufacturers' margins undoubtedly supplied one of the motives for manufacturers' strong support of resale price maintenance in recent years. Resale price maintenance assists manufacturers in retaining the major role in the setting of prices by two influences. On one hand the practice hampers the development of economic power in retailing by retarding market expansion by the retailer. On the other hand it tends to counteract the impact of economic power in retailing by ensuring the manufacturer the use of a relatively large and possibly, excessively large number of outlets. This enables the manufacturer to better resist pressure from the large retailers.

Resale price maintenance also may enable manufacturers to eliminate pressures on their margins from another source. Where resale price maintenance is introduced into an industry it will tend to be adopted industry wide. If the practice is to persist a common retail price level will likely result prompting uniformity in retail and wholesale margins and the resulting similarity in factory prices.

Conversely, where a horizontal agreement exists between manufacturers, resale price maintenance supplies a natural supplement to the arrangement. It prevents retail price competition and its disturbing effects upon both market shares and manufacturers' faith in their competitors' adherence to the

horizontal agreement.

Resale price maintenance could be the main basis for agreements between manufacturers and retailers for their mutual protection. The manufacturers implementation of price maintenance protects the retailers from price competition. In exchange retailers tacitly agree to buy only from the manufacturers concerned and not to buy from manufacturers without a resale price maintenance policy. The manufacturer receives some protection from both new entries into the industry and those manufacturers using more competitive selling methods.

It would appear that resale price maintenance offers manufacturers an opportunity to prevent pressure on their margins from two possible sources. By both impeding and providing a possible defense against economic power in retailing the practice limits the pressure from the other side of the market, the retailers, on manufacturers' profit margins. Either as a means to or a supplement to horizontal agreements resale price maintenance can be used as a means of preventing pressure on manufacturers' margins through price competition at the factory level.

The manufacturers' requests for protection from the so-called "loss-leader" practice are attempts designed toward obtaining some type of price control at the retail level. The inability to arrive at a clear cut definition of a "loss-leader"

plus the lack of proof that manufacturers' sales are in any way detrimentally affected by loss-leader competition tends to lead to a rejection of the argument. Any legislation designed to control loss-leaders, such as the Canadian Amendment of 1960, will tend to create a situation in which manufacturers will be able to influence minimum resale prices.

Any benefits claimed for the consumer from the practice have failed to be substantiated. The consumer is actually penalized in several ways. He is forced to pay a higher price than he might otherwise have to pay if price competition were present because of the resulting higher margins at both the retail and wholesale level plus the possibility of excessive margins at the manufacturing level. In addition the consumer is made to pay for services that he may not desire. He is denied the choice of a corresponding reduction in price in lieu of the services. The very denial of this choice severely restricts the consumers' influence on the distribution system and hence the development of more efficient methods of distribution with their implication for lower prices.

The inefficient use of resources may occur in both distribution and manufacturing as a result of resale price maintenance.

At both the retail and wholesale level the elimination of price competition will tend to result in the greater absorption of resources into services. The higher guaranteed margins

will attract new firms involving unneeded resources into areas which already have a tendency to excess capacity. While providing protection for the high cost marginal operator the practice at the same time will hamper the development of the more efficient use of resources in distribution. The net result is to draw a greater portion of the national resources into distribution than would be necessary under price competition.

At the manufacturing level resale price maintenance may result in or perform as an aid to a non-competitive price structure. Competitive energies of manufacturers will then tend to be diverted to advertising and sales promotion on a larger scale than under price competition. This coupled with the cost of policing resale price maintenance will tend to increase manufacturers' costs. In addition any decreases in production costs resulting from technological improvement or increased volume are likely to be used for greater sales promotion as opposed to being passed on as price reductions as might be the case under price competition.

Resale price maintenance appears to be a restrictive practice which does not serve the public interest. By contributing to non-competitive price structures at all levels it tends to divert competitive efforts to increased and excessive distribution services with the resulting inefficient use of resources. By eliminating price competition it retards the development of

more efficient methods of distribution with their implications for lower prices.

Resale price maintenance through higher prices forces the consumer to assume the burden of higher distribution costs, to subsidize inefficient distributors and to contribute to higher profits of manufacturers.

APPENDIX

THE COMBINES INVESTIGATION ACT

Part V. Sections 33 and 34

33. Every person who is a party or privy to or knowingly assists in, or in the formation of, a merger or monopoly is guilty of an indictable offence and is liable to imprisonment for two years.

Merger and monopoly are defined in Subsection 2(e) and 2(f) respectively of the Act as follows:

"merger" means the acquisition by one or more persons, whether by purchase or lease of shares or assets or otherwise, of any control over or interest in the whole or part of the business of a competitor, supplier, customer or any other trade person, whereby competition

- (i) in a trade or industry,
- (ii) among the sources of supply of a trade or industry
- (iii) among the outlets for sales of a trade or industry, or
- (iv) otherwise than in subparagraphs (i), (ii) and (iii),

is or is likely to be lessened to the detriment or against the interest of the public, whether consumers, producers or others;

"monopoly" means a situation where one or more persons either substantially or completely control throughout Canada or any area thereof the class or species of business in which they are engaged and have operated such business or are likely to operate it to the detriment or against the interest of the public, whether consumers, producers or others, but a situation shall not be deemed a monopoly within the meaning of this paragraph by reason only of the

the exercise of any right or enjoyment of any interest derived under the Patent Act, or any other Act of the Parliament of Canada - Editors)

33A. (1) Every one engaged in a business who

- (a) is a party or privy to, or assists in, any sale that discriminates to his knowledge, directly or indirectly, against competitors of a purchaser of articles from him in that any discount, rebate, allowance, price concession or other advantage is granted to the purchaser over and above any discount, rebate, allowance, price concession or other advantage that, at the time the articles are sold to such purchaser, is available to such competitors in respect of a sale of articles of like quality and quantity;
- (b) engages in a policy of selling articles in any area of Canada at prices lower than those exacted by him elsewhere in Canada, having the effect or tendency of substantially lessening competition or eliminating a competitor in such part of Canada, or designed to have such effect; or
- (c) engages in a policy of selling articles at prices unreasonably low, having the effect or tendency of substantially lessening competition or eliminating a competitor, or designed to have such effect.

is guilty of an indictable offence and is liable to imprisonment for two years.

(2) It is not an offence under paragraph (a) subsection (1) to be a party or privy to, or assist in any sale mentioned therein unless the discount, rebate, allowance, price concession or other advantage was granted as part of a practice of discriminating as described in that paragraph.

(3) The provisions of paragraph (a) of subsection (1) shall not be construed to prohibit a co-operative society from returning to producers or consumers, or a co-operative whole-sale society from returning to its constituent retail or whole-sale members, the whole or any part of the net surplus made in its trading operations in proportion to purchases made from or sales made to the society.*

* Section 33A of the Combines Investigation Act was Section 412 of the Criminal Code prior to the 1960 amendment to the Act - Editors.

33B. (1) In this section "allowance" means any discount, rebate, price concession or other advantage that is or purports to be offered or granted for advertising or display purposes and is collateral to a sale or sales of articles but is not applied directly to the selling price.

(2) Every one engaged in a business who is a party or privy to the granting of an allowance to any purchaser that is not offered on proportionate terms to other purchasers in competition with the first-mentioned purchaser (which other purchasers are in this section called "competing purchasers"), is guilty of an indictable offence and is liable to imprisonment for two years.

(3) For the purposes of this section, an allowance is offered on proportionate terms only if

- (a) the allowance offered to a purchaser is in approximately the same proportion to the value of sales to him as the allowance offered to each competing purchaser is to the total value of sales to such competing purchaser,
- (b) in any case where advertising or other expenditures or services are exacted in return therefor, the cost thereof required to be incurred by a purchaser is in approximately the same proportion to the value of sales to him as the cost of such advertising or other expenditures or services required to be incurred by each competing purchaser is to the total value of sales to such competing purchaser, and
- (c) in any case where services are exacted in return therefor, the requirements thereof have regard to the kinds of services that competing purchasers at the same or different levels of distribution are ordinarily able to perform or cause to be performed.

33C. (1) Every one who, for the purpose of promoting the sale or use of an article, makes any materially misleading representation to the public, by any means whatever, concerning the price at which such or like articles have been, are or will be, ordinarily sold, is guilty of an offence punishable on summary conviction.

(2) Subsection (1) does not apply to a person who publishes an advertisement that he accepts in good faith for publication in the ordinary course of his business.

34. (1) In this section "dealer" means a person engaged in the business of manufacturing or supplying or selling any article or commodity.

(2) No dealer shall directly or indirectly by agreement, threat, promise or any other means whatsoever, require or induce or attempt to require or induce any other person to resell an article or commodity

- (a) at a price specified by the dealer or established by agreement,
- (b) at a price not less than a minimum price specified by the dealer or established by agreement,
- (c) at a markup or discount specified by the dealer or established by agreement,
- (d) at a markup not less than a minimum markup specified by the dealer or established by agreement, or
- (e) at a discount not greater than a maximum discount specified by the dealer or established by agreement,

whether such markup or discount or minimum markup or maximum discount is expressed as a percentage or otherwise.

(3) No dealer shall refuse to sell or supply an article or commodity to any other person for the reason that such other person

- (a) has refused to resell or to offer for resale the article or commodity
 - (i) at a price specified by the dealer or established by agreement,
 - (ii) at a price not less than a minimum price specified by the dealer or established by agreement,
 - (iii) at a markup or discount specified by the dealer or established by agreement,
 - (iv) at a markup not less than a minimum markup specified by the dealer or established by agreement, or
 - (v) at a discount not greater than a maximum discount specified by the dealer or established by agreement; or
- (b) has resold or offered to resell the article or commodity

- (i) at a price less than a price or minimum price specified by the dealer or established by agreement,
- (ii) at a markup less than a markup or minimum markup specified by the dealer or established by agreement, or
- (iii) at a discount greater than a discount or maximum discount specified by the dealer or established by agreement.

(4) Every person who violates subsection (2) or (3) is guilty of an indictable offence and is liable on conviction to a fine in the discretion of the court or to imprisonment for a term not exceeding two years or to both. 1951 (2nd Sess.), c. 30, s. 1; 1952, c. 39, s. 4.

(5) Where, in a prosecution under this section, it is proved that the person charged refused or counselled the refusal to sell or supply an article to any other person, no inference unfavourable to the person charged shall be drawn from such evidence if he satisfies the court that he and any one upon whose report he depended had reasonable cause to believe and did believe

- (a) that the other person was making a practice of using articles supplied by the person charged as loss-leaders, that is to say, not for the purpose of making a profit thereon but for purposes of advertising;
- (b) that the other person was making a practice of using articles supplied by the person charged not for the purpose of selling such articles at a profit but for the purpose of attracting customers to his store in the hope of selling them other articles;
- (c) that the other person was making a practice of engaging in misleading advertising in respect of articles supplied by the person charged; or
- (d) that the other person made a practice of not providing the level of servicing that purchasers of such articles might reasonably expect from such other person.

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Personal

Born in Brantford, Ontario - September 15, 1922.
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Education

- 1935-39 Attended Brantford Collegiate Institute
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- 1945-46 Attended Hamilton Rehabilitation School
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- 1945-49 Registered in Commerce and Finance at the
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Other Activities

- 1942-45 Served with Royal Canadian Navy Active Force
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- 1949-52 Associated with Ford Motor Company of Canada as
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- 1952-55 Served with Royal Canadian Navy Permanent Force
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- 1955-61 Resident of Fort Lauderdale, Florida where
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- 1961-64 Secondary school teacher at Essex District High
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- 1963-65 Served as Commanding Officer, University Naval
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